A Monthly Report from The Conference Board

INTERNATIONAL ECONOMIC SCOREBOARD

The Conference Board

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AUGUST, 1986

SUMMARY

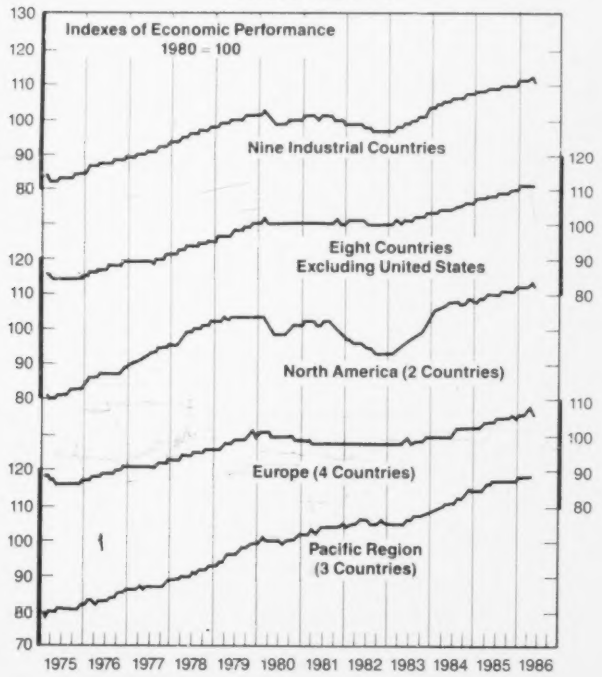
The long worldwide business-cycle expansion continues—at a snail's pace in some countries, fairly rapidly in others. The slow group—those with a 1 or 2 percent growth rate in their economic performance indexes—includes the United States, Canada, the United Kingdom, Italy and Japan. Recent movements of the leading indexes suggest that better times are ahead for the U.S. and Italy, but not for Canada, the U.K. and Japan.

The performance indexes show a brisk 5 percent growth rate for West Germany, France, Australia and Taiwan, R.O.C. The leading indexes for Australia and possibly West Germany, however, suggest that these two countries may not stay on the fast track much longer. At present, only France and Taiwan have the best of both worlds—strong growth now and strong signals for the months ahead.

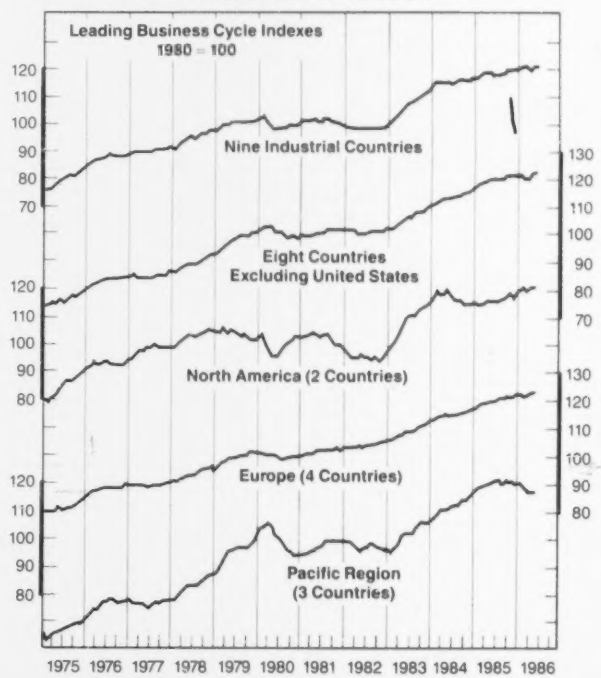
	Ten-year Growth Rate 1969-79	*Indexes of Economic Performance Growth Rates**			*Leading Business Cycle Indexes Growth Rates**			*Current Reading on the Cycle*	*Latest Month Covered*
		6 mos. ago	*3 mos. ago*	*Latest month*	*6 mos. ago*	*3 mos. ago*	*Latest month*		
	annual rates, percent								
9 countries	4	3	3	2	3	3	3	Expansion continuing	May
8 countries ex. U.S.	4	4	3	1	4	0	2	Expansion continuing,leaders weak	May
North America (2)	3	3	3	2	2	6	4	Expansion continuing	May
Europe (4)	3	4	3	1	4	2	5	Expansion continuing	May
Pacific Region (3)	5	3	3	1	3	–3	–4	Expansion continuing, leaders weak	May
United States	3	4	2	1	4	4	4	Expansion continuing	June
Canada	4	5	5	2	5	5	3	Expansion continuing	May
West Germany	3	3	3	5	7	1	2	Expansion continuing, leaders weak	June/May
France	4	6	4	5	4	2	8	Expansion continuing, leaders strong	May
United Kingdom	2	3	2	1	0	–1	0	Expansion continuing, leaders weak	May
Italy	3	1	1	1	6	8	12	Expansion stalling, leaders strong	Apr./May
Japan	5	2	2	1	2	–4	–4	Expansion stalling	May
Australia	4	9	6	5	4	–2	–6	Expansion continuing, leaders weak	May
Taiwan, R.O.C.	10	2	10	5	12	13	14	Expansion continuing, leaders strong	June

* Ratio of current month's index to average index over the preceding 12 months, expressed as a compound annual rate.

Where We Are



Where We're Headed



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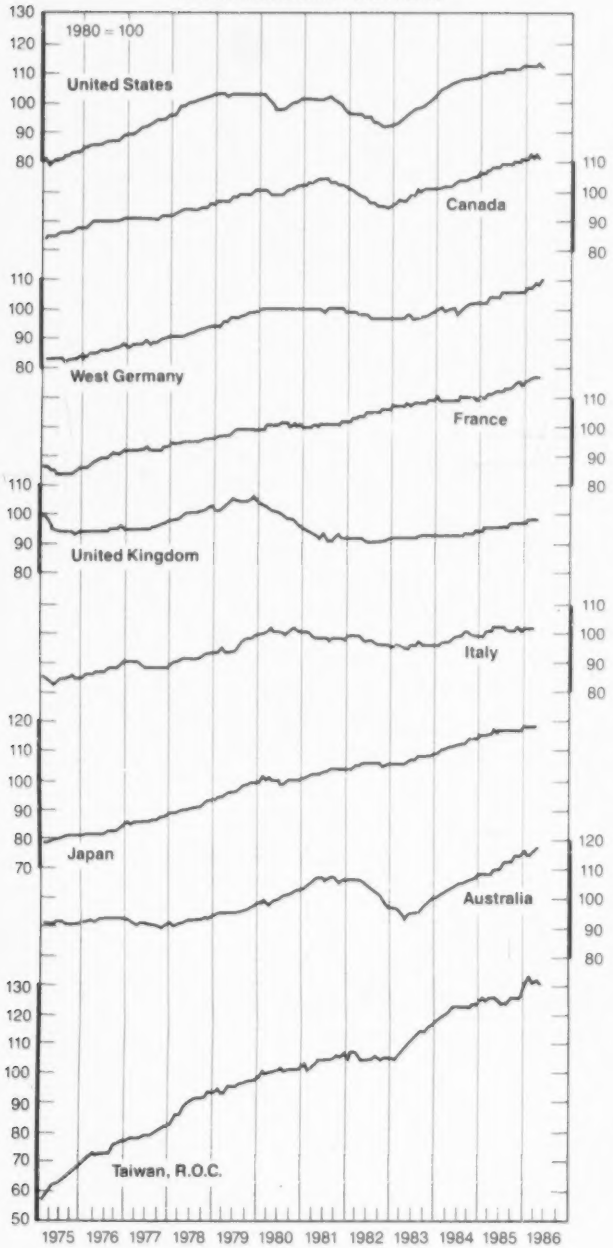
70th Anniversary

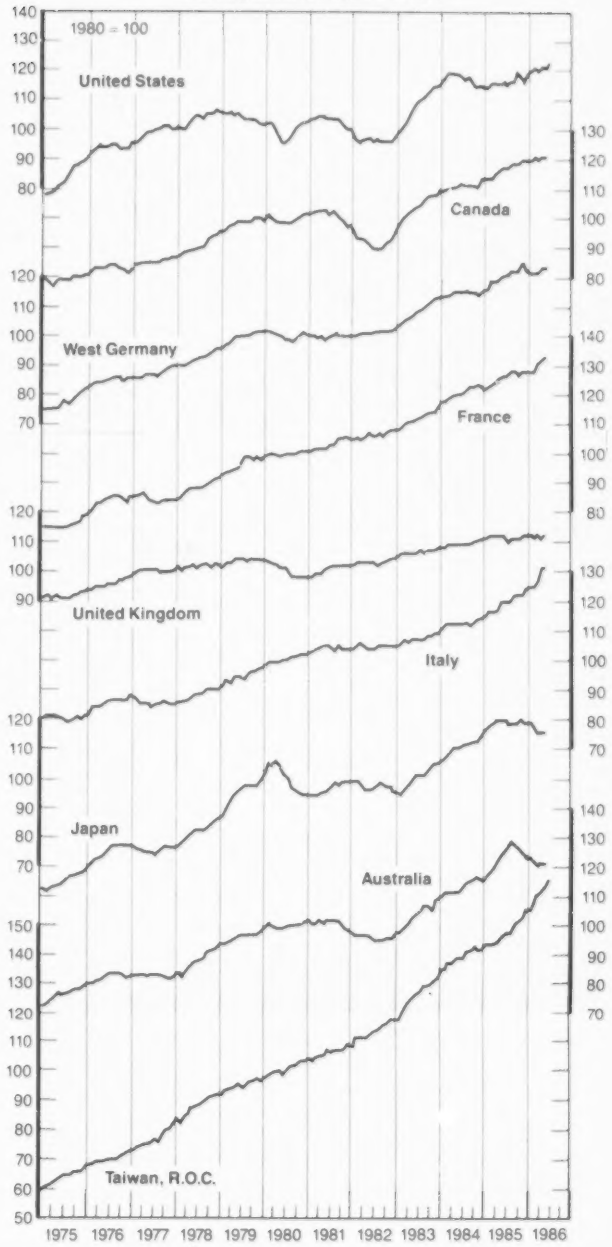
Where We Are

Indexes of Economic Performance



Where We're Headed

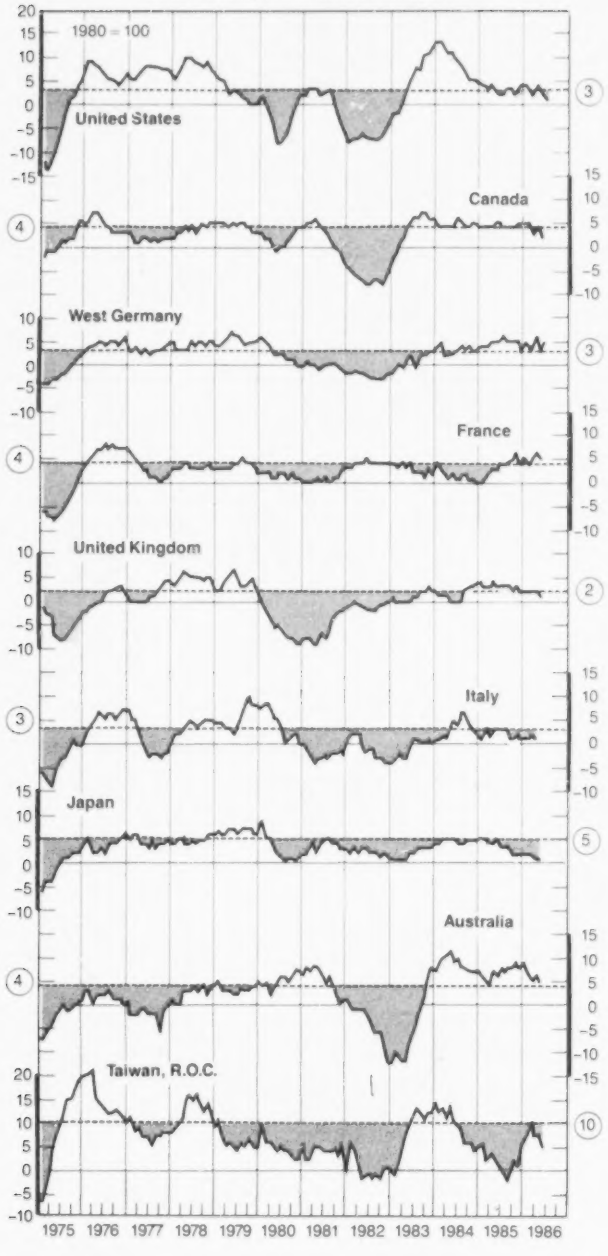
Leading Business Cycle Indexes



Sources: CIBCR and The Conference Board

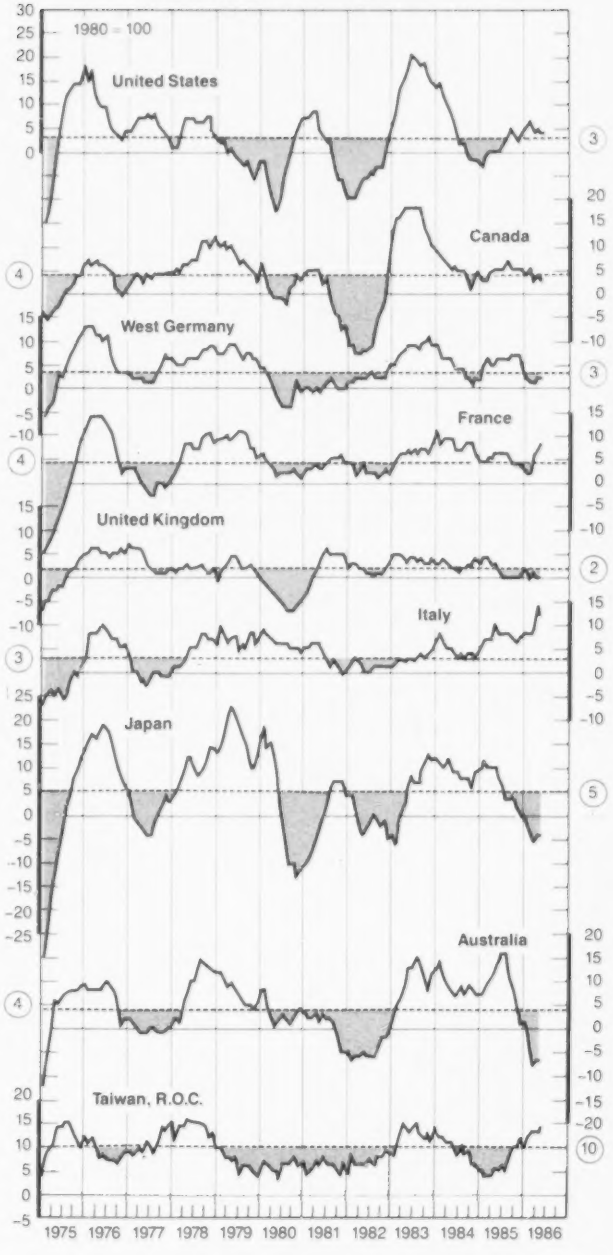
Where We Are

Growth Rates, %, Performance Indexes



Where We're Headed

Growth Rates, %, Leading Indexes



Note: Horizontal dashed lines are average rates for 1969-79 in the index and in Real GNP

Sources: CIBCR and The Conference Board

THE TERMS-OF-TRADE EFFECT ON REAL GROWTH AND INFLATION

When the United States pays lower prices for what it imports and receives higher prices for its exports, as it did when the international value of the dollar advanced sharply from 1980 to early 1985, is the U.S. better off or worse off? Some say "worse off," because the rising dollar intensifies foreign competition. Others say "better off, because cut-rate imports and higher priced exports give us more for our money on both sides of the account.

According to the official data on real GNP, however, changes in export and import prices make no difference. No difference at all? Why not? Well, the reason for such an incongruous result is that the Department of Commerce calculates the international trade component of real GNP (exports minus imports, known as "net exports") by treating exports and imports separately. The nominal dollar value of exports is deflated by an index of export prices, and the nominal dollar value of imports is deflated by an index of the prices of imports. As a consequence, assuming no change in the *quantity* of exports and imports, any change in the relation between export and import prices since the base year (1982) gets washed out. Thus contrary to what some analysts think is common sense, real GNP does not get a boost when import prices go down and export prices go up—nor is real GNP curtailed when it's the other way around.

Commerce calculates net exports this way because it is consistent with measures of the physical volume of exports and imports considered separately. But the difference between the value of exports and imports is also a measure of the change in our claims against foreign countries. An accumulation of such claims is a type of capital formation similar to increased plant, equipment and inventories. These claims increase when we sell our goods to foreigners at higher prices and buy their goods more cheaply. Even though the physical volume of trade may not change, our command over resources has increased. The recent sharp decline in the price of imported oil is another example of such a gain for the country as a whole, despite the unfortunate consequences for domestic oil producers.

This is known as a change in the "terms of trade". As foreign trade becomes a larger part of total economic activity, as has happened in the U.S. in recent years, it becomes more important to take changes in the terms of trade into account. Had we done so in the first quarter of 1986, real GNP would have been $42 billion higher (in 1982 dollars) than the Department of Commerce reported, and the growth in real GNP from the last quarter of 1985 would have been at an annual rate of 4.3 percent instead of 3.8 percent. In the second quarter the difference was much greater. Real GNP would be $61 billion higher, and the growth rate 2.7 percent instead of 0.6 percent. The economic slowdown almost disappears when the terms-of-trade effect is taken into account.

A simple way to do this has been used in recent years by the Center for International Business Cycle Research (CIBCR). The net-export component of GNP is deflated by an index of the general level of prices paid in the United States. The Department of Commerce produces such an index, called the price deflator for gross domestic purchases. It includes the prices of everything in GNP except the net-export component. This omission is important since it is the valuation of the net-export component that is at issue here.

By dividing the net-export balance in current dollars by the gross-domestic-purchases deflator, the balance is expressed in 1982 dollars exactly comparable to those in which the rest of GNP is evaluated. At the same time, any change since 1982 in the relation of export to import prices is allowed to influence the result. Hence a change in the terms of trade is taken into account by this method.

The substantial difference this makes in the net export balance in constant dollars is shown by the following figures, all expressed in billions at annual rates:

	Net exports in current dollars (1)	*Net exports in 1982 dollars*		*Terms-of-trade effect: in 1982 dollars (4)*
		Commerce method (2)	*CIBCR method (3)*	
Q4, 1985	-105.3	-132.0	-94.3	37.7
Q1, 1986	- 93.7	-125.9	-83.5	42.2
Q2, 1986	-100.2	-150.5	-89.2	61.3

The Commerce Department calculation transforms the current-dollar U.S. trade deficit into a larger and still growing real trade deficit, which depresses real GNP. By contrast, the alternative calculation produces a smaller real trade deficit that, like the current-dollar deficit, is declining in 1986. That is why the alternative method of calculating the real trade deficit makes the growth rate in real GNP stronger in the first half of 1986, as noted above.

Still another implication is that the rate of inflation has dropped substantially more than is indicated by the Commerce Department's GNP figures. Between the first and second quarters the GNP inflation rate, according to Commerce's figures, went up from 2.4 percent to 0.3 percent. By the CIBCR method, it dropped from 1.8 percent to 0.2 percent. That is, inflation virtually stopped in the second quarter. This was the result of the improvement in our terms of trade through the decline in imported oil prices. By excluding this effect, the Commerce Department's measure of inflation in GNP omits one of the most important factors that has brought down the inflation rate.

As we look ahead, however, the sharp decline in the dollar since early 1985 is moving the terms of trade against us. Prices of imports are bound to rise relative to prices of our exports. This will do two things: First, it will slow the accumulation of claims against foreigners, which reduces capital formation and slows the growth of the economy. Second, it will accelerate inflation. Neither of these unfavorable developments will show up in the official GNP numbers, because the Commerce Department's method used to measure the real trade balance rubs them out. But they will take place nonetheless.

THE INTERNATIONAL ECONOMIC INDICATOR SYSTEM

This publication is designed to help readers monitor the ups and downs of the business cycle around the world. To this end, two types of index are shown for each country: an index of economic performance and a leading index. The economic performance indexes are composites of such series as real GNP, industrial production, employment and sales—what analysts call "coincident" series, because they *define* the business cycle.

The leading indexes are composites of such series as new orders, construction contracts, corporate profits and stock prices—indicators that usually anticipate changes in production and employment by several months. Thus the indexes of economic performance tell us the current status of the business cycle, i.e., where we are, while the leading indexes tell us where the economy is headed.

Experience has shown that when the leading index begins to rise faster, it is a fairly safe rule that the economy will soon begin to rise faster too—typically after three or four months. When the leading index begins to rise more slowly or to decline, the economy is likely to follow suit shortly thereafter. (For details, see "What the Leading Indicators Indicate," *Across the Board,* April 1980 and *Business Cycles, Inflation and Forecasting,* Ballinger Publishing Co., 1983.) Considerable variation in the length of lead is to be expected, however. Constant monitoring is needed to make effective use of the system and get early warnings of recessions and recoveries, changes in foreign trade flows, and new inflationary trends.

For More Information

To find out more about this indicator system and the availability of detailed data for each country please address inquiries to:

Center for International Business Cycle Research
Columbia Business School
New York, New York 10027
Telephone: 212-280-2916

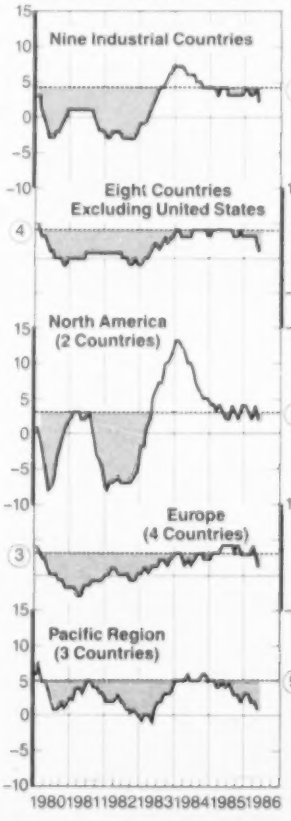
INDEXES, NINE COUNTRIES, 1985-86

		U.S.		Canada		West Germany		France		U.K.		Italy		Japan		Australia		Taiwan, R.O.C.	
		Indexes, 1980 = 100																	
		Perf.	Lead.	Perf.	Lead.	Perf.	Lead.	Perf.	Lead.	Perf.	Lead.	Perf.	Lead.	Perf.	Lead.	Perf.	Lead.	Perf.	Lead.
Apr.	85	110	116	107	116	104	119	111	125	96	112	101	118	116	119	108	122	126	145
May	85	110	116	108	117	104	120	112	126	96	112	102	120	117	119	110	123	126	146
June	85	110	116	108	117	104	120	112	127	96	112	102	120	116	119	110	125	125	147
July	85	110	117	109	118	106	121	113	127	96	110	102	120	117	119	111	128	125	148
Aug.	85	111	117	109	119	106	122	113	128	96	111	101	121	117	118	112	129	124	148
Sept.	85	111	119	109	119	106	122	113	128	97	111	101	122	117	118	113	128	124	151
Oct.	85	111	118	110	119	106	123	114	127	97	111	101	122	117	119	113	127	126	152
Nov.	85	111	117	110	120	106	124	115	128	97	111	102	122	117	119	115	125	126	153
Dec.	85	112	119	111	120	106	123	114	128	97	112	101	124	117	118	115	124	127	156
Jan.	86	112	119	111	120	107	122	115	128	97	112	102	125	116	118	116	124	130	156
Feb.	86	112	121	112	121	107	122	115	128	98	111	102	125	116	116	115	123	131	158
Mar.	86	112	120	111	120	107	122	116	131	98	112	102	127	116	115	115	120	133	161
Apr.	86	113	121	112	121	109	123	117	132	98	111	102	131	118	115	116	121	131	162
May	86	112	121	111	121	108	123	117	133	98	112		131	118	115	117	121	132	164
June	86	112	122			110												131	166
		Growth Rates, Percent																	
Apr.	85	4	0	4	5	5	5	3	5	3	3	2	7	4	10	4	12	3	5
May	85	3	0	5	5	5	5	3	6	4	3	3	10	5	10	7	13	2	5
June	85	2	0	4	5	5	6	3	6	3	2	3	8	4	8	6	14	1	5
July	85	2	2	4	6	6	6	4	6	3	0	3	8	4	6	8	16	-1	6
Aug.	85	3	3	4	7	5	6	4	6	3	0	1	8	4	3	7	16	-2	5
Sept.	85	3	5	4	5	5	7	4	5	2	0	1	8	3	3	8	11	-1	8
Oct.	85	2	3	4	5	5	7	5	4	2	0	1	7	2	4	8	8	2	10
Nov.	85	3	2	5	5	5	7	6	4	3	0	2	6	2	2	9	4	1	10
Dec.	85	4	4	5	5	3	4	4	3	2	1	1	7	2	0	8	1	2	12
Jan.	86	4	5	4	5	5	2	5	2	2	2	1	8	2	0	9	1	6	10
Feb.	86	3	6	5	5	4	1	4	2	2	-1	1	8	2	-4	6	-2	8	12
Mar.	86	2	4	3	3	3	1	5	6	2	1	2	9	2	-5	5	-7	10	13
Apr.	86	4	5	4	4	6	2	6	7	2	0	1	14	1	-4	6	-6	7	13
May	86	2	4	2	3	3	2	5	8	1	0		12	1	-4	5	-6	7	13
June	86	1	4		5													5	14
		Ten Year Annual Growth Rate, Percent																	
1969-79		3	3	4	4	3	3	4	4	3	3	2	2	5	5	4	4	10	10

		9 Countries		8 Countries ex. U.S.		North America (2)		Europe (4)		Pacific Region (3)	
		Indexes, 1980 = 100									
		Perf.	Lead.	Perf.	Lead.	Perf.	Lead.	Perf.	Lead.	Perf.	Lead.
Apr.	85	109	118	108	119	109	116	103	119	115	120
May	85	109	118	108	120	110	116	104	120	116	120
June	85	109	118	108	120	110	116	104	120	116	121
July	85	109	119	109	120	110	117	105	120	116	121
Aug.	85	110	119	109	120	111	117	105	120	117	120
Sept.	85	110	120	109	121	111	119	105	121	117	120
Oct.	85	120	119	110	121	111	118	105	121	117	121
Nov.	85	110	120	110	121	111	117	106	121	117	121
Dec.	85	111	120	110	121	112	119	105	122	117	120
Jan.	86	111	121	110	121	112	120	106	122	118	120
Feb.	86	111	121	111	120	112	121	106	121	118	118
Mar.	86	111	120	111	120	112	120	107	123	118	117
Apr.	86	112	121	111	122	113	121	108	124	118	117
May	86	111	121	111	122	112	121	106	124	118	117
		Growth Rates, Percent									
Apr.	85	4	4	4	7	4	0	3	5	4	10
May	85	4	4	4	7	3	0	4	6	5	10
June	85	3	4	4	7	2	1	4	6	4	8
July	85	3	4	4	6	2	3	4	5	4	7
Aug.	85	4	4	4	5	4	3	4	5	4	5
Sept.	85	3	5	3	5	3	5	3	5	3	4
Oct.	85	3	4	3	5	2	3	4	4	3	5
Nov.	85	3	3	4	4	3	2	4	4	3	3
Dec.	85	3	3	3	3	4	4	3	4	2	1
Jan.	86	4	3	3	2	4	5	3	3	3	1
Feb.	86	3	3	3	0	3	6	3	2	3	-3
Mar.	86	3	2	3	1	2	4	3	4	2	-5
Apr.	86	4	3	3	2	4	5	4	5	2	-4
May	86	2	3	1	2	2	4	1	5	1	-4
		Ten Year Annual Growth Rate, Percent									
1969-79		4	4	4	4	3	3	3	3	5	5

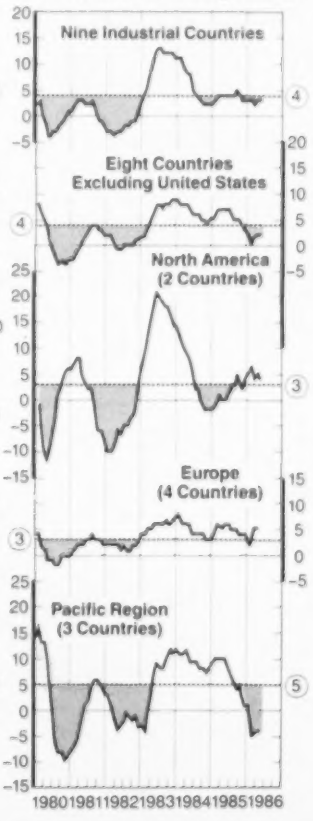
Where We Are

Growth Rates, %, Performing Indexes


Nine Industrial Countries
Eight Countries Excluding United States
North America (2 Countries)
Europe (4 Countries)
Pacific Region (3 Countries)
1980 1981 1982 1983 1984 1985 1986

Where We're Headed

Growth Rates, %, Leading Indexes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Note: Horizontal dashed lines are average growth rates for 1969-79 in the index and in real GNP.
Sources: CIBCR and The Conference Board